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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 354.

In the Matter

of

UNITED CIGAR STORES COMPANY OF AMERICA,
Debtor.

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as trustees,
Petitioners,

GRAYSON M.-P. MURPHY, *et al.*, as a Preferred Stockholders Protective Committee, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR INTERVENOR JACOB RUPPERT REALTY CORPORATION.

M. CARL LEVINE,
Counsel for the Intervenor.

M. CARL LEVINE,
DAVID MORGULAS,
Of Counsel.

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BRIEF OF JACOB RUPPERT REALTY CORPORATION AS AMICUS CURIAE.

The Jacob Ruppert Realty Corporation is a landlord-creditor in these proceedings, having been granted the right to intervene on behalf of a large group of landlord-

claimants, at or about the time the debtor's petition was filed. This brief is filed with the consent of all parties to this proceeding.

The Jacob Ruppert Realty Corporation claim was allowed to the limited extent of three years' damage, in the amount of $219,983.30, without prejudice to whatever right the Jacob Ruppert Realty Corporation had, prior to confirmation of a plan of reorganization, to prove further damage in priority to the interests of stockholders. The order allowing the Ruppert claim is set forth in the appendix.

The Ruppert claim will not be further referred to, all references being to the petitioners' claim.

THE QUESTION.

If the petitioners or any other landlords can prove that they have been damaged in excess of the three-year maximum allowable on a parity with claims provable under Section 63A of the Bankruptcy Act,* should that excess damage claim have a prior right to the remaining assets of the debtor's estate before stockholders can receive any consideration?

THE STATUTE.

Section 77B of the Bankruptcy Act provides:

> "Sec. 77B. Corporate Reorganizations * * *.
>
> (b) * * * (10) The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory con-

* The term "three year maximum", as used herein, includes accrued unpaid rent up to the date of surrender or re-entry as provided in the statutory formula.

tracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts * * * or other interest of whatever character. * * *

In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of re-entry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or re-entry. * * * "

(Act approved June 7, 1934, 48 St. 911, Ch. 424, Sec. 1; U. S. C. Tit. 11, Sec. 207.)

THE OPINIONS BELOW.

The Special Master recommended that the petitioners' claim for damages for breach of the indemnity covenant in the lease be allowed on a parity with debts provable under Section 63A of the Bankruptcy Act to the extent of three years' rent, and that all questions as to the balance of the claim should be reserved until the time for the classification of creditors and the consideration of a plan of reorganization (R. 88, 93).

The District Court modified the Special Master's report in that it completely limited the claim to the extent of the three years' rent provable on a parity with debts under Section 63A of the Bankruptcy Act and barred consideration of the balance of the claim (R. 116-118).

The Circuit Court of Appeals affirmed the order of the District Court (R. 150), 85 F. (2d) 35.

SUMMARY OF ARGUMENT.

POINT I

A landlord is entitled to prove as against stockholders any and all damages sustained in excess of the three year maximum allowed on a parity with other debts provable under Section 63A of the Bankruptcy Act.

POINT II

In any event, the Special Master correctly ruled that the petitioners' claim for damages sustained in excess of the three year allowance on a parity with debts provable under Section 63A of the Bankruptcy Act should be reserved until creditors were classified and a plan of reorganization considered.

ARGUMENT.

POINT I

A landlord is entitled to prove as against stockholders any and all damages sustained in excess of the three year maximum allowed on a parity with other debts provable under Section 63A of the Bankruptcy Act.

The rights of neither bondholders nor general creditors are involved.

The issue narrows itself to whether stockholders shall acquire whatever balance of assets remains after payment to bondholders and creditors on a parity with them, while landlords must forfeit their right to indemnity for any damages sustained in excess of the three-year allowance.

Section 77B contains only one provision affecting the rights of landlord-claimants (sub. b [10]):

> "The Claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under Sec. 63 (a) of this act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry."

The Act does not limit the complete provability of a landlord's claim as against stockholders.

It is important that the Act directs that the claim be "treated" on a parity with debts provable under Section

63A to the extent of three years' rental. By using the word "treat" in relation to such debts it is obvious that a landlord's claim was being divided into two categories: (a) in relation to debts provable under Section 63A there was to be a limitation; (b) in relation to all other debts and rights there was to be no limitation. Any other interpretation would give no consideration whatsoever to the use of the word "treated".

It is indeed highly significant that at the same time Section 77B was enacted, Section 63A of the Bankruptcy Act was also amended by adding subdivision (7) thereto so as to make a landlord's claim for damages provable in bankruptcy to the extent of one year's rent, viz:

> "and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date."

It is apparent that when Congress intended a direct limitation it was so stated in unmistakable language by the use of the following:

> "Shall in no event be allowed in an amount exceeding * * *."

If Congress intended that a landlord's claim should be limited in 77B proceedings to three years' rent, it would have so specifically provided, just as a direct limitation was provided by the aforesaid amendment to Section 63A. The use of the word "treated" in the 77B amendment as against the language of direct limitation in 63A renders

impossible any interpretation which would require a limitation of a landlord's claim as against stockholders.

The factual situation in this very proceeding makes the stockholders' contention incredible. At the time that the debtor filed its petition for reorganization (June 14, 1934), the debtor was in bankruptcy and 50 percent in dividends had already been paid. There were more than enough remaining assets to fully pay all provable and allowed bankruptcy claims and leave the business intact for contingent creditors, of whom the landlords were undoubtedly the largest class. Although landlords had no provable claims in bankruptcy, yet their claims survived bankruptcy and were still fully intact and existent in the event there was a surplus after payment of all claims provable in bankruptcy. That surplus belonged to the landlords to the complete exclusion of the stockholders. Under these circumstances contingent creditors would have been enabled to fully prove their entire damage claims before stockholders could receive anything.

Northern Pacific Ry. Co. v. *Boyd*, 228 U. S. 482.

By the enactment of 77B, Congress certainly did not intend to diminish the rights of landlords. If anything, the statute sought to benefit landlords and make their claims provable even on a parity with bondholders, but limited to a maximum of three years' rent. Nothing was said, however, about the balance of a landlord's claim for it was hardly conceivable that a company which could pay general creditors and bondholders 100 percent, landlord-creditors 100 percent of their three-year maximum and could still have sufficient assets remaining would avail itself of Section 77B. Yet, that is the situation at bar. It can hardly be urged that under such circumstances landlords are to forego recoupment of their total loss by making a gift to stockholders.

Legislative acts must be construed so as to prevent any unconstitutional results. *United States* v. *Delaware & Hudson,* 213 U. S. 366. To argue that Congress intended to deprive one class of creditors of their property rights and make an outright gift to stockholders is tantamount to saying that Congress enacted class legislation and deprived landlords of their property without due process. No such interpretation can be indulged in unless there is explicit language to that effect. The most that can be said for the stockholders' position is that the statute might be susceptible of two interpretations. If that be so, the one which would render the statute clearly constitutional must be adopted as against an interpretation which would render its constitutionality doubtful.

Arkansas National Gas Co. v. *Arkansas Railroad Commissioners,* 261 U. S. 379.

Section 77B was enacted to permit corporations to rearrange their debt and refund their obligations but not to permit them to wipe out their debt or scale it down when there were sufficient assets to meet claims in full.

Any other construction of the Act would place landlords at the mercy of any large company which under a threat of reorganization could compel landlords to accept three years' rent as the full value of any long term lease, even though the corporation was fully able to meet all claims in full.

Unquestionably, landlords were entitled to collect their full damages in priority to stockholders, prior to the enactment of 77B, if there were sufficient assets left after provable claims were paid. No construction should be adopted which would deprive landlords of rights they already had, and transfer the benefits of those rights to stockholders.

POINT II

In any event, the Special Master correctly ruled that the petitioners' claim for damages sustained in excess of the three year allowance on a parity with debts provable under Section 63A of the Bankruptcy Act should be reserved until creditors were classified and a plan of reorganization considered.

The Special Master disposed of the contention at bar as follows (R. 88):

> "Whether the Landlords are entitled to an allowance in excess of the three years' period, in subordination to the provable claims, but in priority to stockholders, is not required to be determined at this time. Whether there will be a surplus over and above the amount of provable claims and expenses of administration, how the same is to be distributed and, in fact, the method of payment and manner thereof to the various creditors, will depend upon the classification of creditors, and the respective rights of the various interested parties herein. All these matters will only be presented when the time for classification arrives, and when various questions arise in the consideration and the confirmation of any plan of reorganization. Accordingly I will adopt the suggestion of the Trustee and the opposing Intervenors, and will leave the question as to the allowance of any excess claim for future consideration, as aforesaid."

The claim of the petitioners for damages over the three-year allowance could only have meaning if a surplus of assets remained after payment of the allowable claims. Before it is evident that a surplus exists, discussion about priorities between landlords and stockholders is academic. The Special Master must have felt that it was premature to argue about dividing assets until the record indicated

there was something to argue about and he accordingly decided that the question could not be determined until creditors were classified and a plan of reorganization considered. Then all the equities of the different parties and different groups could be considered, and the remedial purposes of Section 77B readily applied.

It was our contention, in the Courts below, that it would have been most expedient to reserve the consideration of the question at bar to a time when full inquiry could be made as to the fullest extent of the debtor's assets. So important a problem as the one at bar cannot be correctly dealt with until the complete picture of the debtor's situation has been presented to the Court.

The Preferred Stockholders' Committee has consistently argued that the principles enunciated by this Court in *Northern Pacific Ry.* v. *Boyd* (supra) do not conflict with limitation of the landlords' claims urging that the three-year limitation is in effect the embodiment of a fair plan. What is fair in one case, however, would be wholly unfair in the other. If there are sufficient assets left after payment of creditors, bondholders and landlords limited to three years' rent, to make the preferred stock have a fair book value of $50 per share or more, it is unreasonable that the preferred stockholder should thus profit before the landlord's loss has been made whole. Especially so, when the great bulk of present stockholders have undoubtedly purchased their holdings at a fraction of par. It must be remembered that landlords seek recoupment of their losses, while the average stockholder seeks a profit out of his speculation or investment.

This Court has repeatedly held that it would not pass on the constitutionality of statutes unless the party claimed to be aggrieved has shown that he has been deprived of a constitutional right, whether of person or of property. In the present case the question as to whether or not the

landlord's excess claim is to be considered in priority to stockholders can have no importance until the record affirmatively shows that there is a surplus in the estate after the payment of all prior debts. The fact that the petitioner may have a claim does not mean that the claim is worth one cent until the record indicates what the assets of the estate are as against its provable claims.

We respectfully urge that in light of the present record, the question as to allowance of any additional damage to landlords over their three-year allowance should have been reserved until a consideration of a plan of reorganization, as suggested by the Special Master. In that manner, all questions as to constitutionality are avoided.

The Circuit Court of Appeals completely overlooked this principle. Without a record disclosing the complete story of the debtor's financial position, it entertained and decided constitutional questions which undoubtedly deprived many landlord-claimants in this proceeding of their right of indemnity without any opportunity to present the facts and show the unfairness of a ruling which but deprives one class of creditors of their right of recoupment for the benefit of the owners of the corporation.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed insofar as it limited petitioners' claim to a three year limitation, and that petitioners' claim to any damages in excess of the three year maximum already allowed on a parity with debts provable under Section 63A of the Bankruptcy Act be either allowed in priority to rights of stockholders or be reserved for consideration in a plan of reorganization, as suggested by the Special Master.

Respectfully submitted,

M. Carl Levine,
Counsel for the Intervenor,
Jacob Ruppert Realty Corporation.

M. Carl Levine,
David Morgulas,
Of Counsel.

December 2, 1936.

APPENDIX A

DISTRICT COURT OF THE UNITED STATES,

SOUTHERN DISTRICT OF NEW YORK.

IN THE MATTER OF UNITED CIGAR STORES COMPANY OF AMERICA, Debtor.	In Proceedings for Reorganization of a Corporation. No. 59,886.

Upon reading and filing the petition of Irving Trust Company, trustee of the estate of the above-named debtor, verified May 24, 1935, the notice of motion thereon dated May 24, 1935, and the affidavit of Lewin L. Vinton verified May 24, 1935, as to the mailing of said petition and notice of motion to the attorney for the claimant referred to in said petition, and to the attorneys for the intervenors in these proceedings, and the matter having duly come on to be heard before this Court on the 9th day of July, 1935, in pursuance of said notice of motion, and there being no opposition to the granting of said petition,

It is, on motion of Cravath, DeGersdorff, Swaine & Wood, attorneys for said trustee,

REPORTED AND RECOMMENDED that the claim set forth in the proof of claim numbered 5017 and filed herein by Jacob Ruppert Realty Corp. be reduced to and finally allowed in these proceedings in the principal amount of $219,983.30, provided, however,

(1) that such allowance shall be without prejudice in any respect whatever to the right, if any, of said

claimant to secure the allowance of its claim numbered 5017, prior to the confirmation of a plan of reorganization herein, in a further sum representing the difference between (a) the amount of said claim allowable under Section 77B of the Bankruptcy Act, as amended, on a parity with debts which would be provable under Section 63 (a) of said Act and (b) the total amount of claimant's damages for the entire term of the lease upon which said claim is based, in subordination to debts provable under said Section 63 (a) but in priority to the interests of holders of preferred stock and common stock of the debtor herein, and without prejudice to any right of the trustee or any intervenor in these proceedings to oppose the allowance of said claim in any such further sum;

(2) that if it shall be finally determined in any proceeding herein in which the claimant attempts to prove damages with respect to its claim numbered 5017 in a further sum than said amount of $219,983.30, that the total amount of damages for the entire term of the lease upon which said claim is based is less than the sum of $219,983.30, then the amount for which the claim is hereby allowed shall be further reduced to the amount of damages for the entire term of the lease; and

(3) that the determination whether the claimant has the right reserved for future determination as provided in (1) above shall be governed by the final decision of this Court or (if appealed from) any higher Federal Court in the matter of any other claim in this proceeding involving such question.

Dated, New York, N. Y., July 18, 1935.

IRWIN KURTZ,
Special Master.

APPENDIX B

SUPREME COURT OF THE UNITED STATES

In the Matter of

UNITED CIGAR STORES COMPANY OF AMERICA,

Debtor,

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as Trustees,

Petitioners in No. 354.

IT IS HEREBY STIPULATED AND AGREED that the JACOB RUPPERT REALTY CORPORATION, one of the intervenors in the above entitled proceeding, be permitted to file briefs amicus curiae in the above entitled appeal.

Dated, New York, November 9th, 1936.

M. CARL LEVINE,
Attorney for Jacob Ruppert
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Kuehner and Frederick G. Fischer,
in cause No. 354.

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MILBANK, TWEED, HOPE & WEBB,
Counsel for respondent Phoenix Securities Corporation.

WRIGHT, GORDON, ZACHRY & PARLIN,
Counsel for respondent Reorganization Committee.

CRAVATH, DE GERSDORFF, SWAINE & WOOD,
Counsel for Trustee.